

**PENSION REFORM COMMITTEE
MEETING OF
Tuesday, December 2, 2003
4:00 PM – 6:00 PM Meeting**

**401 B Street
Conference Room, 4th Floor**

MINUTES

**THE REGULAR MEETINGS OF THE PENSION REFORM COMMITTEE ARE
SCHEDULED FOR EVERY TUESDAY AT 4:00 PM AT 401 B STREET, 4TH FLOOR**

Item 1: Call to Order

Item 2: Roll Call

<u>Members Present</u>	<u>Members Absent</u>	<u>Staff Present</u>
April Boling	Richard Vortmann	Patricia Frazier
Steve Austin		Chris Morris
Robert Butterfield		Mary Braunwarth
Tim Considine		Larry Grissom, SDCERS Staff
Stanley Elmore		Paul Barnett, SDCERS Staff
Judith Italiano		Dennis Gibson
William Sheffler		Pam Holmberg
Kathleen Walsh-Rotto		

Item 3: Approval of Minutes

Judie Italiano made a motion for approval of the Minutes of the November 25, 2003 Pension Reform Committee (Committee) meeting. The motion was seconded by Kathleen Walsh-Rotto. The motion passed unanimously.

Item 4: Distribution of Undistributed Surplus Earnings

Larry Grissom, the Retirement Administrator for SDCERS, gave a presentation and answered questions on the distribution of surplus earnings. Please see the attached copy of his presentation.

Jim Gleason, a City Retiree, gave public comment on the distribution of surplus earnings. He believes surplus earnings is a misnomer because earnings achieved by the System's assets represent earnings from contributions to the System from current plan employees, the City, and retirees during their career with the City. He said the San Diego Municipal Code describes the accounts to which earnings should be credited, but the Retirement Board has the sole discretion to allocate the amount of earnings to various accounts. He said in recent years the Board has

credited interest to the employee and employer contribution accounts above the actual level of earnings which is a detriment to other accounts. He recommended the complete overhaul of the Municipal Code system to assure that earnings are equitably distributed, and benefits that are currently dependent on earnings should be made actuarial liabilities to the System.

Item 5: Work Plan for the Pension Reform Committee

Ms. Boling distributed the revised draft outline of a final report for the Committee's consideration. She asked that the Committee review the document to insure that everyone's ideas had been incorporated.

Two additional outlines were distributed to the Committee for consideration. First, Mr. Austin distributed a report he created, entitled Actuarial Audit Project, that compares the scope of the Retirement Board's actuarial audit to the information the Committee is seeking for their final report. Mr. Austin said the purpose of the outline is to identify opportunities to change the scope of the Retirement Board's actuarial audit. Mr. Austin suggested it may be practical for either him or Mr. Sheffler to sit down with Mercer, the Retirement Board's audit firm, to explore the feasibility and cost of changing the scope of the audit. Mr. Grissom added that the informational items identified in the outline fall into one of three categories: 1) within the scope of the audit, 2) could be added to the audit with a change in scope with no additional cost, and 3) could be added to the audit with a change in scope and additional cost. Mr. Grissom reiterated that while items could be added to the scope of the audit, any additional expense would have to be paid by the Committee.

Mr. Considine distributed the outline he prepared, entitled Form of Report, Required Resources, to help identify what information the Committee needs and the resources required to get the information. He said his intention was to help estimate how much the Committee needs to budget to complete their report.

The Committee discussed the three outlines and made suggestions for revisions. Ms. Boling said that she needs to understand what information is currently available through SDCERS and needs to meet with Mr. Grissom and possibly call Committee members for clarification on items within the outline. Ms. Boling requested that Mr. Grissom review the final report outline and indicate if: 1) an item was within the scope of the audit, b) could be added to the audit with a change of scope with no additional cost, c) could be added to the audit with a change in scope and additional cost, and d) if the information is currently available through SDCERS. Chris Morris of the City Attorney's Office reminded the Committee that serial phone calls for the purpose of forming a consensus to Committee members could violate the Brown Act. Ms. Boling confirmed that any calls she would make would be only to seek clarification of a specific Committee member's intent with respect to wording in the outline. The revised outlines will be discussed again next meeting.

Item 6: Comments by Committee Chairperson

Ms. Boling announced that due to scheduling conflicts, Deputy City Manager Bruce Herring would not be able to give a presentation about the meet and confer process until December 16. The presentation on 401K, SPSP and Deferred Compensation will be moved to December 9.

Item 7: Comments by Committee Members

Mr. Morris responded to a question previously raised about legal defense and indemnification for Committee members. He said under the City Charter, the City Attorney has the responsibility and obligation to defend and represent all members of the Committee and City employees for any claims made against them which relate to the dispensation of their duties on behalf of the City.

Questions were raised by Committee members about the process to secure a budget for the Committee. Mr. Morris said that typically a budget request is sent to the City Manager's office and then, depending on the amount, the request goes to the City Council for approval. However, in this case, Ms. Boling would most likely start the process with a dialog with the Mayor. Ms. Boling said she would meet with Mr. Grissom and further clarify what type of studies the Committee might need. She will report back to the Committee on their discussion at the December 9 meeting.

Mr. Butterfield asked who would write the final report. Ms. Boling said it will be written by the Committee and Ms. Walsh-Rotto has volunteered one of her staff to do the word processing. City staff will publish the document.

Item 8: Non-Agenda Public Comment

Jean Hughes, a retired City employee, commented on collective bargaining and the different levels of benefits for classified and unclassified employees. She said there is no information given to the general members about unclassified and managerial benefits. She said the subject of different tiers of benefits for different groups should be addressed at the December 16 meeting when there is a presentation on collective bargaining.

Item 9: Adjournment

The meeting was adjourned at 5:40.

The next meeting will be on Tuesday, December 9 at 4:00 PM at the same location.



TODAY'S PRESENTATION

- History of “the Waterfall” – SDCERS Distribution of Earnings
- Review of applicable Municipal Code Provisions
- An example of the Distribution of Earnings as of June 30, 2001



SDCERS DISTRIBUTION OF EARNINGS

- The earnings of the System are defined as realized, or cash, earnings. They are comprised of interest and dividends received, net purchase discounts and premiums on fixed income instruments, and net realized gains and losses on the sale of stocks. Distribution of earnings is determined by the Board in priority order established in the Municipal Code.



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (1)	Credit the contribution accounts of the employers (City and UPD) and members of the System (City and UPD) at a rate determined by the Board. Historically, the rate has been the actuarial assumption rate, which is currently 8%.
SDMC 24.1502 (a) (2)	The System's operating budget.
SDMC 24.1502 (a) (3)	"An amount necessary to maintain such reserves as the Board deems appropriate on advice of its investment counselor and/or Actuary;" The Board has created three (3) reserves under this section: the General Reserve; the DROP Contribution Reserve and the Net Pension Obligation (NPO) Reserve. NPO is the actuarial present value of the difference between the employer contribution rate recommended by the Actuary and the rate actually paid by the City. As a part of the annual actuarial valuation, the Actuary recommends the amount of this reserve. The schedule shows the difference between that recommendation and the current reserve balance. NOTE: The NPO Reserve has been discontinued.



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (4)	Proportional share of earnings to UPD. This represents the UPD's share of earnings used to fund programs or benefits in which they do not participate, such as retiree health insurance.
SDMC 24.1502 (a) (5)	Health Insurance.
SDMC 24.1502 (a) (6)	13th Check.
SDMC 24.1502 (a) (7)	Corbett Retiree Benefit.



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (8)	Credit the Supplemental COLA Reserve and the Employee Contribution Reserve with earnings at the same rate as the Employee and Employer Contribution Reserves above, currently 8%.
SDMC 24.1502 (b)	The remaining balance is credited to the Employer Contribution Reserve "... for the sole and exclusive purpose of reducing Retirement System liability."



SDCERS DISTRIBUTION OF EARNINGS

UNDISTRIBUTED EARNINGS	AT 6-30-01	\$168,027,467
SDMC 24.1502 (a) (1)	EMPLOYER CONTRIBUTION RESERVE	<\$ 31,375,621>
SDMC 24.1502 (a) (1)	EMPLOYEE CONTRIBUTION RESERVE	<\$ 22,644,858>
SDMC 24.1502 (a) (2)	ADMINISTRATIVE BUDGET (Operations and Investment Management)	<\$ 20,341,882>
SDMC 24.1502 (a) (3)	CREDIT DROP ACCOUNTS AT 8%	<\$ 4,207,312>



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (4)	EMPLOYER CONTRIBUTION RESERVE UPD (HEALTH INSURANCE)	<\$ 837,549>
SDMC 24.1502 (a) (4)	EMPLOYER CONTRIBUTION RESERVE UPD(EMPLOYEE CONTRIBUTION RATE RESERVE)	<\$ 189,493>
SDMC 24.1502 (a) (4)	EMPLOYER CONTRIBUTION RESERVE UPD(PROPORTIONAL SHARE CORBETT)	<\$ 310,050>



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (5)	EMPLOYER CONTRIBUTION RESERVE CITY (HEALTH INSURANCE)	<\$ 14,317,073>
SDMC 24.1502 (a) (6)	13th CHECK	<\$ 3,850,000>
SDMC 24.1502 (a) (7)	CORBETT ANNUAL PAYMENT	<\$ 23,614,741>
SDMC 24.1502 (a) (8)	CREDIT SUPPLEMENTAL COLA RESERVE AT 8%	<\$ 2,848,815>



SDCERS DISTRIBUTION OF EARNINGS

SDMC 24.1502 (a) (8)	CREDIT EMPLOYEE CONTRIBUTION RATE RESERVE AT 8%	< \$ 3,239,204 >
SDMC 24.1502 (a) (3)	NPO RESERVE	< \$ 8,000,000 >
	TOTAL DISTRIBUTIONS	< \$ 117,461,857 >
SDMC 24.1502 (b)	TO EMPLOYER CONTRIBUTION RESERVE	<u>\$ 50,565,610</u>



CONCLUSION

- The Distribution of Earnings is determined by the Municipal Code which requires City Council action to change.
- SDCERS has established an adhoc Earnings Distribution Committee which has made recommendations to improve and simplify the earnings distribution process.

“Actuarial Audit” Project

Original Scope

Pension Reform Committee Needs

<p>Evaluation of economic assumptions for appropriateness.</p> <p><u>As to the latest actuarial valuation as of June 30, 2002, the audit shall include but not be limited to the following objectives:</u></p> <p>Evaluation of the available data for the performance of such valuation, the degree to which such data is sufficient to support the conclusions of the valuation and the use and appropriateness of any assumptions made regarding such data.</p> <p>Evaluation of economic assumptions for appropriateness.</p> <p>Appropriateness of funding methodology, amortization period and resultant contribution rates.</p> <p>Evaluation of actuarial asset smoothing method.</p> <p>Evaluation of recommended adjustments.</p> <p>Relative to current and recent past industry norms, how significant is the System’s current and projected (based on the current Manager’s Proposal) underfunding? If deemed to be significant, what are the potential alternative solutions?</p>	<p>Model out necessary City pension payment to CERS by year and show the required percent of City Budget they will represent.</p> <p>Develop alternatives if the above drain on City Budget is perceived unachievable.</p> <p>Fund current shortfalls with pension bonds; model this out for annual impact on City Budget.</p> <p>Replace current define benefit plan with define contribution plan.</p> <p>Mandate immediate full funding on any new benefit increases with a specified, say 10 years, maximum on funding of any past service obligation resulting from the new benefit.</p> <p>Benchmark current level of pension benefits, employee contributions, etc. against other government agencies and against private industry norms, adjusting for employee contributions to and benefits from social security.</p> <p>The City has extended retiree health benefits to all employees. The City is not funding this liability on an actuarial basis. The City is not even paying current cash costs of current retiree population’s health insurance – rather these costs are being paid out of CERs “excess earnings”. As a result, if these benefits are to be paid in the future to all current employees, there will be a huge burden on future taxpayers for today’s employment costs.</p> <p>Model out on an actuarial basis, the necessary annual funding payments for this liability and show what percent of the City budget this represents.</p> <p>To clear the current uncertainty and conflicting allegations, analyze and conclude on the causes of the current under funded status of CERS, starting say in 1990.</p> <p>Shortfall of City contributions versus true actuarial requirements.</p> <p>Granting of new benefits without corresponding full funding, and the past service obligation created even if full funding of new normal costs.</p> <p>Dissipation of plan assets for “contingent benefits”.</p> <p>Distribution of plan assets for disability pensions relative to assumption for such in actuarial formulas.</p> <p>Determine whether/which “contingent” benefits should be deemed vested benefits.</p> <p>Eliminate the “bells and whistles” which have been added to the basic vanilla defined benefit pension plan (e.g. drop and purchased service credits).</p> <p>Review and pass judgment on the key actuarial assumptions being used by CER’s, particularly the earnings assumption of 8% in light of today’s economy.</p>
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Pension Reform Committee
12/2/03

Tim Considine

Form of Report
Required Resources

Form of Report	Required Resources
<u>The Current Position of Pension Trust</u>	
1. Selection of Date	Annual Audit 6/30/03
2. Actuarial Assumptions (ours)	Actuarial Support
3. Amount of Basic Pension Liability	Need Appropriate Budget
4. Amount of Other Unfunded Liabilities	<u>\$40,000??</u>
A. 13th Check	
B. Retiree Health Benefits	
C. Death Benefit	
D. Change in Retirement Factors (1997)	
E. 50 Percent Industrial Retirement Benefit	
F. Continued Health Coverage for Surviving Spouse	
G. Corbett Settlement	
H. Drop Costs	
I. Increase in LORP Retirement Calculation Factor	
J. Increase in GM Retirement Calculation Factor	
K. Other Issues	
5. Administration of Trust Funds	Studies By Financial Experts
A. Investment Returns	<u>\$2,500??</u>
B. Service Provided	

Pension Reform Committee
12/2/03

Tim Considine

Form of Report
Required Resources

Form of Report	Required Resources
<u>The Reasons For Our Current Position</u>	
1. Lack of City Funding of Basic Pension Benefit	Actuarial Report
2. The City Granting of Unfunded Benefits	See Actuarial Report
3. Investment Performance	Financial Report
4. Pension Board Acceptance of Responsibility for Unfunded Liabilities	
5. The Measurement of Contributions from City (PUC vs. EAN)	Actuarial Report
6. Drop Benefits	
7. Purchased Service Credits	
8. Prior Actuarial Assumptions	

Pension Reform Committee
12/2/03

Tim Considine

Form of Report
Required Resources

Form of Report	Required Resources
<p data-bbox="453 447 618 485"><u>Basic Facts</u></p> <ol style="list-style-type: none"><li data-bbox="185 527 794 600">1. Comparability of Values and Benefits to Outside Sources<li data-bbox="185 642 870 680">2. Comparability of Benefits to Outside Sources<li data-bbox="185 722 837 795">3. Composition of Pension Boards of Outside Agencies<li data-bbox="185 837 483 875">4. Process Conflicts<li data-bbox="185 917 451 955">5. Investment Mix	

Pension Reform Committee
12/2/03

Tim Considine

Form of Report
Required Resources

Form of Report	Required Resources
<p><u>Determined Goals for Pension Trust</u></p> <ol style="list-style-type: none">1. Trust Benefits Should Be Made Straight-forward and Simple2. All Trust Benefits Should Be Fully Funded on an Actuarial Basis3. All Actuarial Assumptions Should Be Realistic4. Governance Board to Be Totally Independent5. Governance Board Should Not Accept Unfunded Liabilities6. Investment Mix Should Meet Prudent Man Standard	

Pension Reform Committee
12/2/03

Tim Considine

Form of Report
Required Resources

Form of Report	Required Resources
<p><u>Committee Recommendations</u></p> <ol style="list-style-type: none">1. Defined Benefit vs. Contribution2. Pension Bonds vs. Agreed Payment Schedule3. Change in Governance Board4. All Future Benefit Grants to be Currently Funded5. Change in Investment Standards <p>38 - Domestic Stock 15 - Non US Stocks 32 - Domestic Bonds 5 - Non US Bonds 10 - Real Estate <u>100</u></p>	

Total Budget Required Probably in 50-75,000 Range